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Message Text

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INR-07 L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15

USIA-06 AID-05 EB-07 CIEP-01 TRSE-00 STR-04 OMB-01

CEA-01 COME-00 FRB-03 XMB-02 OPIC-03 LAB-04 SIL-01

AGR-05 /113 W
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R 160855Z AUG 76
FM AMEMBASSY DACCA
TO SECSTATE WASHDC 1702
INFO AMCONSUL CALCUTTA
AMEMBASSY ISLAMABAD
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AMEMBASSY MANILA
AMEMBASSY NEW DELHI

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PASS AID

MANILA FOR USADB

EO 11652: N/A
TAGS: EFIN, BG
SUBJ: BANGLADESH BUDGET 1976/1977: ANALYTICAL COMMENTS

REF: (A) DACCA 3294, (B) DACCA 3870

1. SUMMARY: THE 1976/1977 BUDGET CONTINUES WELCOME POLICY DIRECTIONS AND AIMS AT CONSOLIDATING THE CURRENT STABILIZATION PROGRAM, BUT THE OBJECTIVE OF A BALANCED BUDGET IS NOT LIKELY TO BE ACHIEVED. THIS IS LOOMING AS A MAJOR ISSUE WITH IMF. THE TAX EFFORT IS MINIMAL IN THIS ELECTION YEAR, ALTHOUGH AGRICULTURAL INCOME IS TO BE TAXED, TAXES FURTHER SIMPLIFIED, AND COLLECTION MACHINERY
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STRENGTHENED. PROJECTED REVENUE EXPENDITURES GROW RELATIVELY LESS

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THAN DEVELOPMENT EXPENDITURES, BM THE ABSOLUTE LEVEL OF DEPENDENCE ON FOREIGN AID IS NOT REDUCED. THE FIRST FULL YEAR EFFECT OF THE 75/76 FOOD SUBSIDY REDUCTIONS IS BENEFICIAL, BUT NO NEW FOOD SUBSIDY REDUCTIONS ARE CONTEMPLATED. IN SUM, ALONG WITH SENSIBLE POLICY GOALS AND SOME IMPROVEMENTS, THERE IS LITTLE PROGRESS TOWARD TACKLING THE MASSIVE FINANCIAL AND FISCAL PROBLEMS: LOW RETURNS FROM PUBLIC SECTOR CORPORATIONS, LARGE AGRICULTURAL INPUT AND FOOD SALE SUBSIDY LOSSES, AND DEPENDENCE ON AID FLOWS TO FINANCE DEVELOPMENT EXPENDITURES. THUS THE BUDGET LACKS CREDIBILITY AS AN EFFECTIVE MEANS TOWARD THE REALIZATION OF BDG DEVELOPMENT GOALS. END SUMMARY.

2. BUDGET FOLLOWS ESTABLISHED POLICIES. THE BDG BUDGET FOLLOWS CLOSELY ON ECONOMIC POLICY DECISIONS PREVIOUSLY TAKEN.

(A) IN AGRICULTURE, THE PROCUREMENT PRICE IS UNCHANGED FROM LAST YEAR'S RELATIVELY HIGH LEVEL (COMPARED TO MARKET PRICES) AND THE FOOD BUDGET ASSUMES A 500,000 MT PROCUREMENT LEVEL, UP FROM LAST YEAR'S ASSUMPTION OF 200,000 MT AND 75/76 ACTUAL PROCUREMENT OF 445,000.

(B) ESTABLISHMENT COSTS IN 76/77 (BE) HAVE BEEN HELD TO LOWER RATES OF INCREASE (16 PERCENT OVER 75/76 (BE)) THAN TAX RECEIPTS (PLUS 24 PERCENT) AND THIS 16 PERCENT INCREASE DOES NOT EXCEED THE INCREASE PLANNED FOR DEVELOPMENT EXPENDITURES. TO HOLD DOWN REVENUE EXPEDITURES REQUIRED FURTHER POSTPONEMENT OF LONG-DELAYED SALARY INCREASES, A DECISION MADE SOMEWHAT LESS DIFFICULT BY THE FALL OF RICE PRICES, BUT STILL TOUGH ENOUGH IN THE PRESENT FRAGILE POLITICAL
CLIMATE HERE.

3. STABILIZATION PROGRAM. THE BUDGET SPEECH (REFTEL A) EMDFYASIZED THE IMPORTANCE OF CONTINUED STABILITY, INCLUDING KEEPING THE PRICE LEVEL UNDER CONTROL AND "ABOVE ALL" NO RESORT TO DEFICIM FINANCING. THIS CONSISTENT WITH THE FY 76 STAND-BY AGREENHNT AND WITH THE UNDERSTANDINGS REACHED WITH IMF OFFICIALS IN MAY CONCERNING THE BROAD OUTLINES OF AN FY77 STAND-BY AGREEMENT. THESE OBJECTIVES ARE
TO BE ACHIEVED BY MOBILIZING DOMESTIC RESOURCES, SPECIFICALLY, NEW TAX MEASURES, CONTROLOF NON-DEVELOPMENT EXPENDITURES, AND REDUCTION OF SUBSIDIES. THE TAX INCREASES ARE MINIMAL, THE CONTROL OF EXPENDITURES IMPRESSIVE (PARA 2B ABOVE) AND THE REDUCTION OF SUBSIDIES IMPORTANT IN THIER FINANCIAL EFFECT THIS YEAR.
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(A) TAX INCREASES. (I) OVERALL. THE NEW TAXES ANNOUNCED IN THE 76/77 BUDGET WILL INCREASE TAX REVENUES ONLY 2.2 PERCENT THIS YEAR. TOTAL TAX RECEIPTS IN 75/76 (RE) WERE TAKA 6.5 BILLION AND ARE TO GROW TO 7.3 IN 76/77, BUT THE NET EFFECT OF THE NEW TAX MEASURES INCLUDED IN THAGGCDGET ADDS ONLY TAKA 0.16 BILLION. THE RATIO OF TAX COLLECTED TO GDP IS TO RISE FROM 7.2 PERCENT (75/76) TO "NEARLY 8 PERCENT" IN 76/77. WHILE IMPROVING YEAR TOHYEAR, THIS IS STILL VERY LOW BY INTERNATIONAL

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STANDARDS. BY CONSOLIDATING A HETEROGENEOUS GROUPS OF
RENTS, LEASES, DUES AND TAXES, THE N IW LAND DEVELOPMENT TAX GREATLY
L
EXEMPLIFIESTHE CALCULATION AND COLLECTION OF THESE TAXES,
EVIDENCE OF FURTHER PROGRESS IN IMPROVING TAX MACHINERY.
(IIUB #
JAGRICULTURAL INCOME TAX. TAKA 150 MILLION IS TO COME FROM
AGRICULTURAL INCOME AS SUCH AND 250 MILLION FROM CLOSING A LOOPHOLE
TO LAND-HOLDING URBAN-DWELLERS WITH OTHER
INCOME SOURCES. THESE AMOUNTS ARE VERY SMALL, BUT THE
BUDGET SPEECH PREDICTS A SUBSTANTIAL INCREASE IN FUTURE YEARS. THIS
WAS NOT AN EASY TIME TO LEVY SUCH A TAX. RICE PRICES HAVE FALLEN
SHARPLY AND THE FARMER IS LESS EASILY ABLE TO PAY. THE
BENEFITTING FARMERS ARE ALSO TO BE CHARGED 3 PERCENT OF THE GROSS
BENEFITS FROM CERTAIN IRRIGATION SCHEMES AND
THE FERTILIZER SUBSIDY HAS BEEN REDUCED BY RAISING THE PRICES.
THE AGRICULTURAL TAX DECISION IS ALSO IMPORTANT BECAUSE IT
RESPONDS TO DONOR, AND SPCIFICALLY IMF, ENCOURAGEMENT. FIANALLY,
THIS TAX CLOSES A LOOPHOLE BY WHICH BUSINESSMEN AND MANY GOVERNMENT
SERVANTS WERE AVOIDING TAX LIABILITIES. DESPITE THESE POSITIVE
ASPECTS, AND THE UNDERSTANDABLE REASONS WHY THIS WAS DIFFICULT
YEAR TO IMPOSE THIS TAX, IT REMAIN DISAPPOINTINGLY SMALL.
(B) SUBSIDY REDUCTION. THIS WILL BE THE FIRST FULL YEAR OF
RATION FOODGRAIN SALES ZT#THE HIGHER PRICES ADOPTED IN 75/76, AND
SALES PROCEEDS ARE ESTIMATED AT TK 4.5 BILLION AGAINST 2.9 IN 75/76
(RE) BUT NO FURTHER FOODGRAIN PRICE RISES ARE ASSUMED IN THIS BUDGET.
THE REDUCTION OF THE FERTILIZER SUBSIDY AND IMPOSITION OF IRRIGATION
WATER CHARGES CONTINUE THIS POLICY DIRECTION IN 76/77.

4. DEPENDENCE ON FOREIGN AID. BDG DEPENDENCE ON FOREIGN ASSISTANCE
IS INCREASING IN ABSOLUTE TERMS, AS IS THE TOTAL AMOUNT FINANCED BY
FOREIGN AID AND DEFICIT FINANCING COMBINED. (AIRGRAM FOLLOWS
WITH EXACT AMOUNTS AND METHODOLOGY.) IT IS A MAJOR PURPOSE OF THE IMF
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STABILIZATION PROGRAMS TO REDUCE THIS DEPENDENCE OVER TIME.

NOTE: # AS RECEIVED.

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AGR-05 /113 W
---------- 015998
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5. 1976/77 ADP. (A) COMPOSITION. THE PROPBRHQIOMV OF THE TOTAL FUNDS ALLOCATED IN THE ADP FOR AGRICULTURE AND INDUSTRY IN RECENT YEARS WERE:

	1974/1975	1975/1976	1976/1977
AGRICULTURE	34 PERCENT	32 PERCENT	30 PERCENT
INDUSTRY	12 PERCENT	32 PERCENT	30 PERCENT

HOWEVER, IF ONE SHIFTS THE TK 1.02 BILLION FOR THE ASHUGANJ FERTILIZER PLANT FROM INDUSTRY TO AGRIUCLTURE AND DROPS THE FERTILIZER SUBSIDY (CHARGED TO THE DEVELOPMENT BUDGET), AN IBRD MISSION ECONOMIST CALCULATES THAT THE AMOUNT SPENT ON AGRICULTURE WOULD DOUBLE IN 1976/77 OVER 75/76. THIS IS NOT A SATIS-FACTORY ANSWER, IN OUR VIEW, GIVEN THE OVERWHELMING
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IMPORTANCE OF AGRICULTURE TO THE ECONOMY, THE FACT THAT EXPENDITURES ON PUBLIC SECTOR INDUSTRIES HAVE NOT BROUGHT A REASONABLE RETURN, AND THE IMPORTANCE OF THE AGRICULTURE SECTOR FOR DEVELOPMENT.
(B) SHIFT IN AID RESOURCES. THE FINANCE MINISTRY INFORMS US THAT THE DISBURSEMENT OF FOREIGN AID, ASSUMED BY THE BUDGET FRAMERS, WAS AS FOLLOWS: (IN MILLION OF DOLLARS)

TYPE OF AID	1975/1976	1976/1977

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	(REVISED ESTIMATES)	BUDGET ESTIMATES
FOOD	248.83	281.76
NON-PROJECT	317.73	320.0
PROJECT	129.33	196.4
TOTAL	694.88	798.16

THE BDG IS WORKING TO ACCELERATE PROJECT IMPLEMENTATION, BUT WE DOUBT THE 52 PERCENT INCREASE IN DISBURSEMENTS ASSUMED ABOVE WILL BE ACH-IEVED. THE PROJECTED RISE IN NON-PROJECT AID DISBURSEMENTS MAY ALSO NOT MATERIALIZE IN LIGHT OF PROSPECTS FOR REDUCED IDA LENDING IN 76/77.

6. DEFICIT FINANCING APPEARS UNAVOIDABLE. THE BUDGET POSTULATES AN ESTIMATED 5 PERCENT REAL GROWTH RATE IN THE ECONOMY, WITH THE AGRICULTURE SECTOR TO GROW 2.8 PERCENT AND THE NON-AGRICULTURAL SECTOR 8 TO 9 PERCENT. THESES ASSUMPTIONS ARE OPTIMISTIC. WHILE THE ECONOMY GREW AN IMPRESSIVE 10 TO 11 PERCENT IN 75/76 WITH AGRICULTURAL OUTPUT UP 16 PERCENT OVER FLOOD-AFFECTED 74/75, THE LONGER-TERM GROWTH RATE HAS NOT BEEN 5 PERCENT, BUT BELOW THE 3 PERCENT AT WHICH THE POPULATION IS GROWING. IF WE TAKE THE GROWTH ASSUMPTIONS AS GIVEN, HOWEVER, THERE IS SUCH AN IMPORTANT INCONSISTENCY AS TO RIASE DOUBTS CONCERNING THE BDG COMMITMENT TO A BALANCED BUDGET. IF AGRICULTURAL GROWS 2.8 PERCENT AND FOODGRAIN PRODUCTION EQUALS THE PREDICTED 13.1 MMT MARK, THEN PROCUREMENT OF 500,000 MT, AS ASSUMED BY THE BUDGET FRAMERS, IS POSSIBLE. HOWEVER, RATION OFFTAKES WOULD NOT REACH 1.8 MMT (WE HAVE THESE-BUDGET ASSUMPTIONS FROM FINMIN MJFICIALS).
GIVEN INCREASED AGRICULTURAL OUTPUT AND EXISTING HIGH PUBLIC AND PRIVATE FOOD STOCKS, WE BELIEVE RATION SALES WOULD NOT EXCEED ABOUT 1.4 MMT FOR THE YEAR. THIS DIFFERENCE WOULD REDUCE ESTIMATED REVENUES BY ABOUT 750 MILLION TAKA. AT THE SAME TIME, GIVEN A SECOND BUMPER HARVEST, FARM PRICES GENERALLY WOULD REMAIN LOW AND WITH THEM, FARM INCOME. HENCE, CONSUMER SALES AND THUS IMPORTS WOULD CONTINUE DEPRESSED, RAISING THE POSSIBILITY THAT THE 16.8 PERCENT PROJECTED RISE IN CUSTOMS DUTIES MAY NOT BE REALIZED. THIS
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COMBINATION WOULD PRODUCE A DEFCIT IN 76/77 ON THE ORDER OF THE ESTIMATED TAKA 1.17 BILLION DEFECIT IN 75/76. THE DEGREE OF HAALISM IN THE ESTIMATES OF REVENUES IDENTIFIED ABOVE ALSO HAS IMPLICATIONS FOR BANGLADESH'S RELATIONS WITH THE IMF. IMF MISSIOM MEMBERS HERE TO NEGOTIATE THE 76/77 STAND-BY ARRANGEMENT SHARE OUR CONCERN OVER THE BDG COMMITMENT TO A BALANCED BUDGET. DESPITE RENEWED BDG ASSURANCES TO AVOID RECOURSE TO DEFICIT FINANCING IN 76/77, THIS LOOMS AS THE MOST IMPORTANT SINGLE ISSUE IN THE NEGOTIATIONS OVER THE FY77 STAND-BY ARRANGEMENT. BDG FAILURE TO ADHERE TO THIS COM-MITMENT COULD HAVE A SERIOUS EFFECT ON THE IMF WILLINGNESS TO CON-TINUE THE STAND-BY AGREEMENT, IMF OFFICIALS TELL US. THERE IS NO EASY WAY TO BALANCE THIS BUDGET UNLESS, PERVERSELY, AGRICULTURAL PRODUCTION DOES NOT GROW, IN WHICH CASE, PROCUREMENT OUTLAYS WOULD BE LOWER AND RATION OFFTAKES HIGHER THAN ESTIMATED.

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7. CHRFCLUSION: THE BUDGET CONTINUES THE WELCOME ECONOMIC POLICIES OF THE PRESENT PROGRAM GOVERNMENT AND, IF IT PROVES TO BE BALANCED, T HE
STABILIZATION PROGRAM OF THE PAST 18 MONTHS. IT RAISE DOMESTIC RESOURCES ONLY MODESTLY BY NEW TAXES, ALTHOUGH BRINGING THE IMPORTANT AREA OF AGRICULTURAL INCOME AT LEAST NOMINALLY WITHIN THE TAX NET. NEVERTHELESS, BANGLADESH'S FUNDAMENTAL ECONOMIC AND FISCAL PROBLEMS REMAIN: THE FOOD SUBSIDY, ALTHOUGH REDUCED IN 75/76, IS ASSUMED NOT TO BE FURTHER REDUCED IN 76/77; PUBLIC SECTOR REVENUES ARE STILL VERY LOW -- THE FIVE-YEAR PLAN AIMED AT A RETURN OF 10 PERCENT; AND THE AGRICULTURAL INPUTS SUBSIDIES DESPITE THE INCREASE IN FERTILIZER PRICES, ARE STILL OVER ONE BILLION TAKA (FERTILIZAER IS 750 MILLION). THE UNREALISITIC REVUENUE ESIMATES CITED EARLIER AND THE OUTLOOK FOR A DEFICIT, DESPITE THE COMMITMENT TO A BALANCED BUDGET, RAISE SERIOUS DOUBTS ABOUT THE EFFECTIVENESS OF THIS BUDGET AS MEANS TOWARD THE REALIZATION OF BDG DEVELOPMENT GOALS. WHETHER OR NOT THE PRESENT POLICY DIRECTION WILL BE CONTINUED, OR PROGRESS MADE TOWARD FINANCING AN INCREASED PORTIONOF DEVELOPMENT EXPENDITURES FROM DOMESTIC RESOURCES IN FUTURE YEARS, WILL DEPEND IN THE NEAR TERM ON THE OUTCOME OF THE CURRENT REVIVAL OF POLITICAL ACITIVITY AND THE ELECTION SCHEDULED FOR EARLY 1977.
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